



Bulletin

2005-07B

FY06 BUDGET ISSUES AND PROCEDURES

TO:	Mayors and Selectmen	City and Town Managers
	Boards of Assessors	Executive Secretaries and Finance Directors
	Auditors and Accountants	City Solicitors and Town Counsel
	Collectors	Regional School District Committees
	Treasurers	Regional School District Superintendents

FROM: James R. Johnson, Director of Accounts

DATE: March 4, 2005

SUBJECT: FY06 Budget Issues

This *Bulletin* addresses several issues cities and towns may consider in development of budgets for FY06.

School Building Payments

Chapter 208 of the Acts of 2004 made major changes in the school building assistance program which dates from 1948; Chapter 210 of the Acts of 2004 made major changes in the funding mechanism for such payments. Certain appropriations for school construction programs were not included in the FY05 state budget, since the two Chapters cited above were still being formulated.

During the fall and winter of 2004, the new School Building Authority ("SBA") did make contract assistance payments to about 15 cities, towns and regional school districts which had issued bonds prior to June 30, 2004 but had expected no reimbursement payment during FY05. The SBA and Bureau of Accounts worked together to insure that such payments were recognized as receipts (and a reduction of a debt exclusion under Proposition 2 ½, if applicable) in computing the FY05 tax levy and tax rate. In cases where (a) the tax rate had been approved before the SBA payment was documented or (b) other factors existed that precluded application of such payments, that such payments should either (a) close to fund balance as of June 30, 2005 and free cash as of July 1, 2005 or (b) be reserved for use in developing FY06 budgets in cities and towns or developing FY06 assessments to member cities and towns by regional school districts.

The SBA is now engaged in reviewing numerous projects currently financed by bond anticipation notes ("BANs") by a city, town or regional school district ("issuer"). For projects which are substantially completed, the SBA will in most cases make a lump-sum payment representing the state share of the construction cost and the state share of the interest during the construction period, less a provision for amounts which may result from audits. Such payments are scheduled, where possible, to precede the maturity of the BANs. The issuer in such cases will likely:

- ◆ Reduce the BANs by the lump sum payment from SBA,
- ◆ Renew BANs for the amount retained by SBA pending audits, and
- ◆ Permanently finance the local share by bond issuance.

However, if the project has been excluded under Proposition 2 ½, any amount on the issuer's balance sheet as of June 30, 2004 attributable to either (a) a so-called "Debt Exclusion Timing Shift" (our IGR 02-101 issued in March 2002) or (b) an unamortized bond or note premium (our *Bulletin* 2003-20B issued in October 2003) should be closed and used to reduce the amount of the permanent financing. In this way, the adjustment necessary to exclude the correct amount will be accomplished by a lower amount of principal and interest over the term of the bond.

The SBA is also striving to develop procedures to address the substantial backlog of audits on projects on which cities, towns and regional school districts are receiving annual payments. Such audits may result in adjustments (either positive or negative) which will be reflected over the future stream of payments on each project. We understand that the first such reviews may occur as early as March 2005.

Self-Insurance Plans for Employee Health Insurance

Over sixty cities, towns and other entities operate self-insurance plans for financing employee health insurance under the provisions of Chapter 32B §3A. A very few cities have operated such funds within the general fund, which we feel is inconsistent with the concept of the self-insurance plan with adequate reserves. In these cases, we have suggested adoption of the statute cited above. In other cases, audits of such plans have not been completed on a timely basis, and significant deficits have accumulated with severe fiscal consequences for cities, towns or other entities.

The Governor recently filed House 1, the General Appropriation Act for FY06 with two outside sections that address this subject. Section 55 provides (a) that an audit of such a fund be completed each year (which may be part of the annual audit of the city, town or other entity), (b) that so-called "incurred but not reported" or "IBNR" claims be recognized, and (c) that any deficit in the fund be provided for in the next annual tax rate for a city or town or in the next fiscal year's budget for any other entity. Section 144 would allow any city, town or other entity which reported a deficit in its health claims trust fund at the end of fiscal year 2004 attributable to failure to record IBNR claims would allow such a deficit to be amortized over three fiscal years beginning in FY06. Without such a provision, we feel that provisions of Chapter 59 §23, the basic statute governing city and town tax rates, require such a deficit to be raised in its entirety.

Hotel / Motel Excise Tax – Optional Local Share

During FY04 and earlier years, errors occurred as a result of data contained in returns filed by certain taxpayers which resulted in higher payments to about 20 cities and towns of the local option share of this tax, due to the incorrect listing of the location of the hotel or motel. Payments made in December 2004 reflected the correct location of each property. The amount of this payment (adjusted for seasonal factors where applicable) should be used in estimating this excise tax for FY06.

In addition, Chapter 502 of the Acts of 2004 appropriated \$3,271,336 for distribution to those cities and towns which had not received, before the effective date of the Act, the full amount of the excise to which they were entitled from September 1, 1998 to August 30, 2004. Payments were made to 12 cities and towns in January 2005. These payments are general fund revenue; however, they are clearly a non-recurring revenue. If the amounts are material, consideration should be given to appropriating such funds from free cash to a stabilization account or a capital purpose after free cash is certified as of July 1, 2005.

Community Preservation Fund

We expect about 75 cities and towns will use this option during FY06. Based on the balance in the State Fund from surcharges at the Registries of Deeds, we expect that the matching funds to be awarded in October 2005 will again be equal to 100% of the surcharge levied by the city or town.

NESWC – Rebates to Member Cities and Towns

The Northeast Solid Waste Committee (NESWC) contracts with 23 cities and towns north of Boston. The current service agreement is due to terminate in September 2005. Funds distributed by NESWC to a city or town upon termination should be considered a general fund receipt, unless the payment to NESWC was made from an enterprise or revolving fund established to account for trash removal purposes. In such cases, the receipt should be considered a receipt of the enterprise or revolving fund. Special legislation may govern in certain cities and towns, and the city solicitor or town counsel should be consulted in such cases. Palmer & Dodge, as counsel to NESWC, has prepared two memoranda which should also be reviewed.

For FY06 tax rate purposes, only funds (a) which have been received when the tax rate recap is submitted or (b) for which the NESWC Board of Directors has provided written assurance that the funds will be paid during the fiscal year may be recognized as estimated local receipts, enterprise fund revenue or revolving fund revenue.

Electric Operations of Cities and Towns – Audits

Many of the approximately forty cities and towns which operate municipal electric plants under provisions of Chapter 164 retain an independent certified public accountant to audit the electric operations, other than the firm which performs the city or town audit. One reason may be that the electric plants operate on a fiscal year ending December 31 as opposed to the municipal fiscal year which ends June 30. The electric results are then included in the audit of the city or town as a “component unit” relying on the opinion prepared by the other firm.

In such cases, the audit report for the electric operations must be filed with the director of accounts, as required by provisions of Chapter 44 § 42. The notification of engagement of the firm is also required under the same section.

Certification of City, Town, District and Regional School District Notes And Receipt of Audit Reports

Audit Reports of cities, towns and districts are required if receipt of federal funds exceed threshold amounts promulgated by the federal Office of Management and Budget. Audits of regional school districts are required under provisions of Chapter 71 § 16A. In recent years, concerns have arisen as to certification of “State House Notes” under provisions of Chapter 44 §§ 23-27 in the absence of current audits of issuers of the notes. Effective with certification of notes in FY06, we will not certify revenue notes of a city, town, district or regional school district if a required audit is not submitted within one year of the period covered by the audit, *e. g.*, if the audit for the period ended June 30, 2004 is not submitted by June 30, 2005.

Enterprise Funds – Allocation of Indirect Costs

Costs incurred in general fund departments to support enterprise activities may be allocated to the enterprise fund, if computed on a fair and consistent basis, and documented properly. In recent years, cases have arisen relative to allocation to an enterprise of costs incurred in prior fiscal periods, due to delays in beginning the enterprise’s operations at the start of the fiscal year, or similar reasons. We feel that while such cases may have merit, that restoring payments to the general fund should be subject to reasonable limits.

Effective with approval of the tax levy and tax rate for FY06, no reimbursement of indirect, startup or allocated costs from a period greater than two prior fiscal years prior to the year at issue will be recognized as costs of the enterprise.

Budget Options Not Available in FY06

Provisions of the so-called “Municipal Relief Act,” Chapter 46 of the Acts of 2003 permitted deferral of a portion of pension costs in FY04 and FY05, and permitted appropriation of proceeds from sale of real estate owned by a city or town for any municipal purpose, not limited by provisions of Chapter 44 § 63. Neither provision is available in FY06.

Storm Expenses of January 2005

Press reports have indicated that the Federal Emergency Management Agency will consider applications from cities and towns for reimbursement of qualifying expenditures incurred within a 72-hour period at the inception of this storm. In the past, such claims have been administered by the Massachusetts Emergency Management Agency in Framingham. Consistent with past practice, if the reimbursements are not received by June 30, 2005, we will allow accrual of the amount for which an application was timely submitted, and will not deduct the amount or require it to be raised in the FY06 tax rate pursuant to Chapter 44 § 31D if received prior to September 30, 2005.

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Please contact your Bureau of Accounts field representative with questions.